

Cambodia introduces transfer pricing rules

October 2017 (2nd Issue)



 ***The following report may be of interest to:***

General enterprises especially **those with significant related-party transactions**

 ***Prakas in brief***

On 10 October 2017, the Ministry of Economy and Finance issued Prakas No. 986 MEF.PrK. to provide 'rules and procedures on income and expense allocation among related parties' (known as the 'Local Transfer Pricing Rules'), which is effective immediately. The Prakas represents one of the most important developments in the Cambodian tax regulations in the last 20 years. In addition to being in line with Cambodia's tax reform plans, this regulation also demonstrates Cambodia's commitment to aligning with global tax frameworks on transparency and combatting tax avoidance.

The Prakas defines the transfer price as 'the price of goods, services, or property charged between related parties'. Transfer pricing (TP) refers to setting the value of transactions (e.g. the sale or purchase of goods or services, royalties or interest etc.) between related parties using the most appropriate transfer pricing methodology. If the transactions aren't at arm's length, the tax authority may adjust the value and impose taxes accordingly.

The purpose of transfer pricing rules is typically to make sure related entities compensate each other appropriately in an amount that is commensurate with the value of property transferred or services provided and to prevent entities from manipulating profits between related parties to minimise tax exposure.

We've summarised key information from the Prakas, including the definition of related party, acceptable transfer pricing methodologies and the required documentation, below.

Related party definition

The Prakas defines 'related party' as a relative of the taxpayer or an enterprise that controls, is controlled by, or is under common control with the taxpayer. The term 'control' means ownership of 20% or more of the equity interest in the enterprise or voting power of the board of directors.

Transfer pricing methodologies

The acceptable methodologies for determining arm's length pricing under the Prakas are those endorsed by the Organisation for Economic Co-operation and Development (OECD) in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The five methodologies are described below:

Transfer pricing method	How it works	When to use it
Comparable Uncontrolled Price (CUP)	The CUP method compares the price charged for goods or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction.	The CUP method is generally the most direct and reliable way to measure an arm's length result for the same property in substantially the same circumstances as the controlled transaction. But it can be difficult to find a transaction that is similar enough that no differences have a material effect on the price.
Resale Price (RP)	This method determines the arm's length price by deducting an appropriate gross margin for the activities of the reseller from the actual resale price.	RP is the easiest method to use if the distributors do not add significant value to the product transferred.
Cost Plus (CP)	The arm's length price is determined by adding an appropriate mark-up to the cost of the product or service.	This method is most useful for sales of semi-finished goods, joint facility agreements, long-term buy-and-supply arrangements and the provision of services.
Transactional Net Margin Method (TNMM)	TNMM compares the net profit margin relative to an appropriate base (e.g. costs, sales or assets) that a taxpayer realises from a controlled transaction to an appropriate base. It is similar to the cost plus and resale price methods but at the net profit margin level.	TNMM applies to cases where one of the parties contributes unique intangibles, while the other party does not make any unique contribution.
Profit Split Method (PSM)	This method establishes transfer pricing by dividing the profits of a multinational company in a way that would	PSM is the most appropriate method in cases where both parties to a transaction make unique and valuable

	be expected of independent companies in a joint-venture relationship. Independent companies would split the combined profit in proportion to the value of their respective contributions to the generation of profit in the transaction.	contributions to the transactions.
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Transfer pricing documentation

Entities which transact with related parties must prepare and maintain transfer pricing documentation setting out related-party transactions and the transfer pricing methodologies used to justify an arm's length value. Documents related to the transactions, such as invoices, must also be kept for ten years from the tax year end.

Entities must also disclose related-party transactions when filing their annual corporate income tax return (CIT) and provide relevant transfer pricing documents if required by the tax authority.



Our view

The new transfer pricing rules will contribute to improving transparency and combatting tax evasion. It also provides more comprehensive guidelines to help taxpayers comply with the tax regulations and minimise the risk of challenge during a tax audit. But, they will also create extra work and compliance costs for taxpayers.

There are also areas that the Prakas doesn't cover that will need to be discussed with relevant authorities. For instance, the Prakas is silent on what data sources are appropriate for conducting a benchmarking study, the deadline for filing transfer pricing documentation, transfer pricing exemptions, the language of the documentation, and whether the guidelines will be applied retrospectively. This type of uncertainty is common when new rules are introduced. We'll seek more information from the relevant authorities and keep you updated.



How the Transfer Pricing Prakas impacts you?

If you have related-party transactions, you need to prepare and maintain transfer pricing documentation to justify the amount charged on transactions among related parties so that it can be provided to the tax authority on request. Even if you don't have any related-party transactions yet, you should consider transfer pricing for future transactions.

The potential risk of TP and relevant tax reassessment could be very significant. This could also result in double taxation, interest on underpaid tax and substantial penalties.



What you need to do next?

As the Prakas is already effective, you should review whether you have significant related party transactions and assess the potential TP risk. If you have, you need to

review whether the transactions are conducted at arm's length and make sure you have adequate transfer pricing documentation.

We anticipate that there will be challenges in meeting these new requirements. So we'll be holding a **seminar** in the coming weeks to help you better understand the new rules.



How we can help you?

We're pleased to discuss the impact of these rules on your business and help you to make sure you're well-prepared.

We have a team of local transfer pricing specialists who have transfer pricing experience from overseas assignments, as well as access to a range of experts from international PwC firms. We've already helped our international and local clients with advice on transfer pricing and documentation for various transfer pricing projects.

To talk about how we can help you, please contact one of transfer pricing experts below or speak to your usual PwC contact.

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Our Newsbrief provides a periodic summary of new rulings and documents relating to legal, tax, and investment developments in Cambodia.



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